NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on May 18-19, 2016 that relates to *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard—Dividing Responsibility for the Audit with Another Accounting Firm*. The other topics discussed during the May 18-19, 2016 meeting are not included in this transcript excerpt. The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript, which may contain typographical or other errors or omissions. An archive of the webcast of the entire meeting can be found on the Public Company Accounting Oversight Board's website at: https://pcaobus.org/News/Events/Pages/SAG-meeting-May-2016.aspx.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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STANDING ADVISORY GROUP

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MEETING

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THURSDAY
MAY 19, 2016

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The Advisory Group met at the Washington Plaza Hotel, 10 Thomas Circle, Northwest, Washington, D.C., at 8:30 a.m., James R. Doty, Chairman, presiding.

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LILLIAN CEYNOWA, Associate Chief Auditor
JENNIFER RAND, Deputy Chief Auditor
JESSICA WATTS, Associate Chief Auditor
KEITH WILSON, Deputy Chief Auditor

MAY 18, 2016

MR. BAUMANN:

…

Let me turn to the next topic, the supervision of other auditors. This was a very important proposal to issue. We had a couple of standard which actually already addressed the use of other auditors.

And the standards in my view clearly needed improvement in terms of really directing the lead auditor to take responsibility and oversight for the work of those other auditors. The existing standard wasn't really risk-based in terms of the lead auditor's oversight of the work of other auditors.

Separately, our inspections had noticed sufficient deficiencies in the work of other auditors in performing their work that the lead auditor didn't find as part of their overview of that work. And so improving the standards such that the lead auditor has greater involvement in and responsibility for the work and oversight of the work of the other auditors should improve the audit quality done by those many other firms around the world who may have different incentives in performing their work than the lead auditor who had final responsibility for the audit.

On April 12th, the Board issued this proposal to strengthen the requirements for lead auditors and provide a more uniform approach to supervision in audits that involve other auditors. It amends existing requirements pertaining to supervision, planning, documentation as well as the not concurring partner but engagement quality review with respect to other auditors.

There are also a relatively few instances where the lead auditor doesn't have the ability to get into review or see the work of those other auditors. If that's the case, we don't think that the lead auditor should nonetheless take responsibility for the entire audit if they can't have access to the work done by the other auditor.

That happens most frequently in the situations we see where there might be an equity investment that's significant and Management doesn't have the ability to get their own audit of the top company to get their lead auditor into that equity investee and they have a different auditor in that company.

This proposal includes a new standard for circumstances in which the lead auditor divides responsibility with another firm. That was permitted under existing standards. This new standard increases somewhat the responsibilities of the lead auditor in determining the qualifications of that other auditor when they divide responsibility. That other auditor has to be mentioned in the audit report including the scope of work and the amount of work that they performed. The comment period on this ends on July 29, 2016.

Again, as I mentioned, some of the key changes, this applies a single approach for supervision. There were a couple of standards that could be applied in this world of supervising other auditors. So this is a single approach for the supervision of the work of all other auditors when the lead auditor assumes responsibility for that work. As I mentioned, this is linked in and tied into our risk assessment standards.

It includes more specific requirements for the lead auditor's supervision of other auditors to prompt the other auditors to be more involved in the work of those other auditors especially in the areas of greatest risk of material misstatement. Really, our incentive here is that the lead auditor be very actively involved in and is required to be actively involved in determining the scope of work that the other auditors do, setting a tolerable misstatement for the other auditors, determining what type of opinion that they want from the other auditors or what type of report or work papers they want sent back and determine that all of that was done and conclude that the other auditor performed the work in accordance with those instructions.

It also includes a requirement that whenever other auditors work on the audit determine that the firm issuing the audit report sufficiently participates in the audit to serve as the lead auditor. Again, we have seen some instances where -- and I mentioned a case before -- maybe the lead auditor did maybe a handful of the work and 90 percent of the work was done in some other market by some other auditor.

Hopefully, this new standard would not permit that to happen as the lead auditor has to audit a significant portion of the risks of material misstatement with respect to that any particular audit. And guidance and rules are given with respect to the determination as to whether or not your participation is sufficient for you to serve as the lead auditor.

The proposed standard also strengthens existing standards by providing more specific requirements regarding the lead auditor's responsibility to gain an understanding of the qualifications of the other auditors at the outset of the audit including an understanding as to whether or not they'll be able to gain access to the work papers of those other auditors. But it's really geared to make sure that the lead auditor knows who is the engagement partner on the many different subsidiaries around the world and the other lead people who are responsible for supervision and are those the right people. Do they have the right capabilities for this particular industry and for this particular audit to support that work and to do high quality auditing to support the role of the lead auditor?

You have to gain that understanding about the qualifications at the outset of the audit in order to set the proper scope of work to be performed and to set the proper capability for you to have the right work to review.

As I said, this proposal will be reviewed and discussed in more detail tomorrow.

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MS. MOONEY: On the other auditors when I'm thinking about China and some other Asian jurisdictions, I'm curious. Is there deference? I'm trying to figure out how the supervision works for like the multi-nationals? Will there be deference to the local laws in some areas? Would the auditors need to get visas to get -- I mean how will they be able to step up supervision where there are restrictions like that?

MR. BAUMANN: The lead auditor has to fulfill the planning and supervisory responsibilities of the audit with respect to all other auditors wherever they're located and there's no distinction drawn. If the lead auditor is unable to get satisfactory access to the work done, unable to review work papers that the lead auditor thinks he or she needs to review, that would be a scope limitation.

MS. MOONEY: Thank you.

MR. BAUMANN: So there's no deference given to the fact that you can do less work and serve as a lead auditor if some of the work's done in some other market.

Philip, did you have a follow-up on that?

MR. JOHNSON: That's where I have an issue with having the proposed new standard allowing other auditors to be named in the audit opinion. I think it's basically having two opinions.

From my perspective, the lead auditor is providing assurance over the financial statements as a whole. I guess there is an equity investor. And you can't get access to the work papers of the auditor as you described. Then I think that's a scope limitation and should be said rather than having the standard.

From my perspective I think that it should be one opinion and I'm picking on what was said there. And I was going to raise that point and then raise it again next time. But I think because of this exchange I think it is important that we don't treat matters in a different way just because you can't get access into China. It's no different than having access to another U.S. firm, for example, on a particular aspect of that balance sheet.

MR. BAUMANN: This is getting back to the divided responsibility scenario and sort of backing off the auditor reporting model. But these questions, that's alright. We'll take them. They're important.

We're interested in comments on the proposal. But I guess there are two alternatives and one is let's just say -- And I don't think this is an issue with respect to China really. Typically auditors are able to get access to that audit work and to review the work there.

This is typically more of a situation where there's a separate ownership issue -- let's say an equity investee or something -- where the corporation has an equity investee that's material to the financial statements. But they have their own auditor. And the lead auditor just can't get into that company to review that work.

Rather than having a scope limitation, this provides the possibility for that other auditor to do an audit in accordance with PCAOB standards of that separate entity and for it to be disclosed in the audit report that with respect to a certain amount of the assets or a certain amount of the revenue or income that the auditor report relies entirely on that other audit of that portion of the audit.

And that auditor is named in that report. That financial statements and that audit report are filed with Securities and Exchange Commission and are available for investors to see.

Again, interested to see and have comments on that if some think that's not right. I do know the IAASB standard, the analogous standard for group audits, does not permit divided responsibility; whereas the U.S. does.

Liz, did you have a question on this same issue?

MS. MURRALL: You actually have just answered my question because it was about the fact that other international standards do not have this divided responsibility and just how they address it. I think from an institution investor perspective we firmly believe that the group auditor should take responsibility for the audit as a whole as Philip has articulated.

MR. BAUMANN: We do, too. And we hoped that would be the case. I said this is relatively few cases, but if the lead auditor cannot for whatever reasons then the question arises is it better to have a scope limitation and not have an unqualified opinion. Or is it better to have the ability to have another auditor do an audit in accordance with PCAOB standards which means we'd have the ability -- which gives transparency to that work to the investor.

But again, we have that out for comment. And we'll be interested in views on that.

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May 19, 2016

MR. BAUMANN: We'll be beginning this final session shortly.

So our final session is an important one, as everything on the agenda has been important to us and hopefully to you.

We did issue just recently a proposal in a very important area, and that deals with the lead auditors' involvement in planning, supervision, review, et cetera, of the work of other auditors. As you know, in most multinational engagements there can be very significant portions of the work done in many places around the world and that can add up to a very significant piece of the revenue and assets and income of the company. And the work, therefore, of other auditors is critical to the success of the audit. And so, this proposal dealing with the lead auditors' involvement and supervision of that work is key to investor protection and audit quality.

Joining me for this presentation are Keith Wilson, Dima Andriyenko and Lillian Ceynowa.

And I think I'm turning it over to you first, Dima?

MR. ANDRIYENKO: Yes.

MR. BAUMANN: Okay.

MR. ANDRIYENKO: Thank you, Marty.

First, Lillian and I would like to provide a high-level overview of the proposal and after our introduction we're going to pose several discussion questions on the screen.

The proposal that the Board issued on April 12 focuses on a large segment of audits conducted by firms registered with the Board. These are audits that involve not only the firm that issues the audit report on the company's financial statements, what the proposal calls the lead auditor, but also other firms and accountants outside the lead auditor firm, what the proposal calls other auditors.

Other auditors can be accounting firms outside of the lead auditor's global network, but in many instances they are firms from the same network as the lead auditor. For example, if the lead auditor is headquartered in the U.S. and audits a U.S. company that has operations in the U.K. and the U.S. firm uses its U.K. affiliate to audit the company's U.K. operations, the affiliate firm would be considered the other auditor for purposes of the proposal.

The Board's proposal would strengthen the existing standards that govern audits involving other auditors. Today in some situations the lead auditor can assume responsibility for the other auditor's work after performing specified procedures that are not explicitly required to be tailored for the associated risks. The proposal would strengthen existing requirements with respect to supervision of the lead auditor -- by the lead auditor of the other auditors, but also with respect to the planning, documentation and the engagement quarterly review involving other auditors.

Overall the proposed changes are designed to increase the lead auditor's involvement in the work performed by other auditors and also in the evaluation of that work. For example, the proposal includes specific requirements for the lead auditor's review of the work performed by other auditors.

The purpose of the greater involvement by the lead auditor is to enhance the auditor's ability to prevent or detect deficiencies in the work of other auditors. PCAOB inspectors observe deficiencies in the other auditors' work that the lead auditors either did not identify or did not address.

The Board also proposed a new standard for situations in which the lead auditor divides the responsibility for the audit with another accounting firm. In these audits the lead auditor refers to the other firm in the lead auditor's report. And we will discuss these situations in a little bit more detail later in the presentation.

In addition to the discussion questions that you will see in our slides, there are 59 questions in the proposing release and in Appendix 4 to the release. The Board is seeking comments on all aspects of the proposal, including costs and benefits of the proposal and alternatives to the proposal. We're very interested in any empirical data that you can provide that would support your views on the proposal. And the Board is also seeking specific comments on the proposed amendments to existing PCAOB standards and on the proposed new standard.

Now I'm going to turn this over to Lillian and she will provide you with an overview of key changes to the proposal. And then we'll put on the screen our discussion questions.

MS. CEYNOWA: Thank you, Dima.

Now that Dima has provided you with some background a high-level overview of what the Board's proposal is intended to do, let me now highlight for you some key changes. I will start with supervision of audit engagement.

The proposed amendments to the standards do two things: First, the proposed amendments are designed to align the applicable requirements with the PCAOB's risk-based supervisory standards. The Board's proposal will supersede AS 1205, which is currently called AU 543, and establish a uniform risk-based supervision approach. This would result in requiring that in all audits in which the lead auditor assumes responsibility for the work of another auditor the lead auditor would supervise the other auditor's work in accordance with the PCAOB's risk-based supervision auditing standard.

The Board's existing supervision standard and standards for determining the scope of multi-location audit engagements requires more audit attention to areas of greater risk. The existing standard on using the work of other auditors, however, allows the lead auditor in certain situations to limit its involvement to certain specified procedures that are not explicitly required to be tailored for the associated risks.

Applying a risk-based approach would direct the lead auditor's supervisory responsibilities to the areas of greatest risk. This should result in the lead auditor focusing on the riskiest areas of the audit, whether those areas are audited by the lead auditor directly or by another auditor under the lead auditor's supervision. The proposed supervision approach would apply to all auditors, which would include both affiliated accounting firms as well as non-affiliated accounting firms.

The second area of change the Board is proposing in the supervision standard is that it would provide additional direction to the lead auditor on how to apply the principle-based provisions of the Board's existing supervision standard. Additional direction could help the lead auditor assure that its participation in the audit is sufficient for it to carry out its responsibilities and issue an audit report based on sufficient appropriate audit evidence.

The proposed additional direction would required the lead auditor to do the following things: To inform the other auditor in writing of the scope of work, tolerable misstatement and the identified risks of material misstatement; to obtain and review the other auditor's description of the nature, timing and extent of audit procedures to be performed including communicating in writing any changes to the proposed procedures that are necessary; to direct the other auditor to provide for review specified documentation; to obtain from the other auditor a written report describing the other auditor's procedures, findings, conclusions, and, if applicable, opinion; and to determine whether the other auditor complied with the lead auditor's written communications and whether additional audit evidence would be obtained.

Consistent with existing standards the extent of the lead auditor's supervision and review would be determined based on requirements of the standard on supervision. For example, the higher the likelihood of the risk of material misstatement associated with the areas in which other auditors perform audit procedures, the greater should be the extent of the lead auditor's supervision of the other auditor's work.

Now let me turn to two other areas which reside currently in the amendments to the planning standard. Let me highlight two areas: One is sufficiency of participation and the other one is qualifications.

The first area involves the principle that the lead auditor, the auditor signing the audit opinion on the consolidated financial statements, performs audit procedures on a significant or meaningful portion of the financial statements. Currently for audits involving other auditors that are governed by the existing standard AS 1205, the standard we are proposing to supersede, the auditor is required to determine whether its participation is sufficient for it to serve as principle auditor in order to issue an audit report on the consolidated financial statements.

The Board's proposal would extend the requirement for determining the sufficiency of its participation to all audits that involve other auditors, not just those that are currently covered under the existing standard. This would even apply in situations in which the auditor divides responsibility with another accounting firm. This change is designed to increase the likelihood that the firm issuing the auditor's report performs procedures for a meaningful portion of the company's financial statements.

The proposed requirement would do two things: First, it would impose the determination of the requirements specifically on the engagement partner and it would require that the engagement partner determine its sufficiency of participation based on the following things:

It would be based on the risks of material misstatement associated with the portion, including the portions materiality of the company's financial statements, audited by the engagement partner's firm in comparison with portions for which the other auditors perform audit procedures. The proposed risk-based criterion is intended to capture both quantitative and qualitative characteristics of a particular scenario. Under this criterion the lead auditor ordinarily would need to audit the location at which the primary financial statement decisions were made and consolidated financial statements were prepared.

The second item I'd like to talk about is qualifications of the other auditor. The Board's proposal builds on and strengthens the existing standards by requiring that when planning the audit the lead auditor gain on understanding of the qualifications of the other auditors who will assist the lead auditor with planning and supervision, including gaining an understanding of their experience in the industry in which the company operates, knowledge of the relevant financial reporting framework, knowledge of PCAOB standards and SEC rules and regulations.

Gaining an understanding of the knowledge, skill and ability of the other auditors' supervisory personnel is necessary for determining the extent of the lead auditor's supervision of the other auditors. A lack of the appropriate qualifications by the other auditors who assist the lead auditor with planning and supervision could have an adverse effect on the effectiveness of supervision and may increase the likelihood that auditors would not identify material misstatements in the company's financial statements.

The proposed requirements seek to apply a balanced and practical approach by focusing the lead auditor's attention on the qualifications of the more senior engagement team members of the other auditor; that is, those who assist the lead auditor with planning or supervision.

The proposal would also require that the lead auditor during the planning stages of the audit to determine that the lead auditor is able to communicate with the other auditor and is also able to gain access to the work papers.

These proposed amendments of the audit planning standard are designed to alert the lead auditor at the outset of the audit to difficulties they may encounter in obtaining and evaluating audit evidence collected by the other auditors so that the lead auditor may take appropriate action.

MR. ANDRIYENKO: Okay. On the screen now there's a slide with the first of our discussion questions for today. And to tee it up we also included a bit of background information.

The use of other auditors is prevalent today. It is specialists among larger companies audited by larger accounting firms. For example, other auditors are used in over half of audits performed by U.S. global network firms and about a third of audits performed by non-U.S. global network affiliate firms.

By another measure, approximately 80 percent of the Fortune 500 each year audits performed by U.S. global network firms involved other auditors. Other auditors can perform audit procedures in critical audit areas and PCAOB inspections continue to identify deficiencies in the other auditors' work that the lead auditor did not identify or did not address.

So the question is about your views on the need for increased involvement by the lead auditor in the work of other auditors and in the oversight of the other auditors' work.

MR. WILSON: Thanks, Dima.

So we're going to open up for questions or comments that anyone might have on thoughts on this topic. Do you in fact think it is important for the lead auditor to have involvement and oversight of the work?

So we'll begin with Bob Herz.

MR. HERZ: Well, thank you. I'm generally supportive of the objectives of this proposal. I guess it's more of a question, just thinking back to work I did at PwC in terms of global quality and work that I did as the head of the Transnational Auditors Committee if IFAC, of to what extent would the lead auditor be encouraged or permitted to take into account in the evaluation the firm's internal quality control procedures over that other audit affiliated firm, that other auditor?

So if say one of the major parts of the operation of the company being audited were in U.K. and the firm has done a lot of internal controls, internal quality work on the U.K. firm does it and how that can be kind of taken into account and used efficiently and effectively in this process.

MR. WILSON: Thanks. So one reaction to that, I think we do want to get comments in that area. I think it's important for --

the proposal tries to talk about the information that the lead auditor needs to have in evaluating those qualifications. And certainly information could be available to the lead auditor from that perspective.

So we would be interested in comments, people's views and experiences on the extent to which that works today in practice and how well that works and how much information the auditor actually gets as compared to -- and I'm not suggesting that any of the situations you were describing are this way, but as opposed to sort of a blind reliance kind of approach of there is -- we know they have a quality control system. We don't know much about it. We don't know much about the particulars. So I think that's an area that we're very interested in.

Phil Santarelli?

MR. SANTARELLI: Thank you. In response to the question I'm very supportive of the Board taking up this project. I think frankly AU 543 needs modernization. It's a very old standard. The world has changed a lot.

I think as noted in the release many firms have attempted to modernize their procedures with respect to these group audits using ISA 600, which has moved that continuum quite a bit. But I don't think that's necessarily universal. And I think you still have situations where many firms doing a group audit in an international setting may be their only group audit and they're relying on AU 543. And I currently don't believe it's efficient.

So this modernization I think is needed to improve audit quality, and we're supportive of it.

MR. WILSON: Thank you. Rick Murray? MR. MURRAY: The challenge of transnational auditing, the challenge of fitting the audit process and the concomitant regulatory challenges of the globalization of commerce is a major one, and I commend the attention that it's getting here.

It's been a major issue for at least 40 years and it has been a matter that the profession has been working away at pretty diligently through that time. The conditions that existed at national boundaries in the '70s and '80s would look pretty crude to anyone examining practice today. I mention that only to suggest that this is neither new nor unaddressed, but I welcome the attention to how can it be improved.

The concerns that I have or the questions I would put to you are basically twofold: Given the fact that this has been around pretty much forever in terms of global commerce, and it will be, I don't think anyone can assume that whatever action the Board takes in a standard setting now is going to fix the future and be able to say, well, done with that. Now everything's under control.

So I think the idea that seems assumed in this proposal suggests that if the lead audit partner is made to understand that it is his or her responsibility and given the tools and the risk-based demand that they meet that responsibility, that the problem will go away. It won't. It is one that the business community, the capital markets, the audit profession and the regulatory world will continue to struggle with.

So I'm troubled by the sense that this is a solution and troubled by the implication that in taking action at the PCAOB Board level to mandate that the audit partner not only has the responsibilities, which is fine; I don't disagree with that, but has the responsibility also to self-determine that he or she has met those responsibilities is a form of passing the regulatory burden back to the audit profession. And I don't think that's a realistic expectation. MR. BAUMANN: Well, I'd like to maybe just explore that a little bit further. And I don't think that any standard is a complete solution to any particular problem, but it's trying to strike the right balance, of course, whenever we have any new proposal or new standard.

But I think it is the responsibility of the audit firm signing the opinion as opposed to maybe a regulatory burden, I think is what you indicated, to ensure that they have obtained sufficient appropriate evidence, the lead audit firm - the lead audit partner - to sign that opinion. And so, what we're trying to get at here is would the increased involvement and oversight by the lead audit firm on the work of that other auditors contribute to improved audit quality, reduce deficiencies or identification of the deficiencies in the work of the others to improve audit quality and protect investors more?

So it is a problem that's been around for awhile. I think Phil made a very good point that existing Standard AU 543 hasn't changed necessarily with the times. Many of the firms did enhance their models around ISA 600 when that came out, but even Arnold's pointed out that that's another area that they're continuing to look at because as many times as they exposed Group Audit Standard ISA 600, still with experience it shows there are challenges. There are unique incentives between what the lead auditor has to do and the incentives that the other auditor might have in their work at a subsidiary location.

And so, this is trying to get views from commenters about enhancing or increasing the responsibility of the lead auditor to gain an understanding of the qualifications, who the people are performing the work at those other locations. Are they the right people? And then therefore, are the instructions sufficient enough given to those other auditors so they understand them and then perform those procedures and get the right report back to the lead auditor so they can evaluate the work.

So I understand your point that nothing is going to solve this and we don't expect zero deficiencies at the end of the day, but hopefully we reduce the extent of the problems we see today in the work done by other auditors. So I accept the general concern you have and hopefully this is principles-based enough to live a long time. And your point is things will change and evolve again over time. In this standard we tried to make this principles-based that would live for time, but we'll look for comments to see if people think that -- if that's the case.

MR. MURRAY: Thanks, Marty. And I agree with virtually everything you said. I agree with everything you said. What's not quite addressed is why is it then necessary to say that the lead audit partner must self-declare that they've done it and fixed it? They've done everything they need to do to make sure that transnational financial reporting is going to work as intended? Well, it's not. And it's that last step of imposing an unachievable responsibility on a role that cannot have the tools to avoid deficiencies in the future. That's the step that I'm concerned about.

MR. BAUMANN: Great. We'll look for others' comments on what the expectation should be of that lead auditor. Thanks, Rick.

Bob Hirth?

MR. HIRTH: Thanks. I support this overarching concept of the lead auditor and coordinating that and the lead auditor versus the firm taking responsibility. So like Phil said, I think it should be modernized, and it is. So I support all that.

Some of this is all convoluted because of the firm structures. I'll explain that in a second.

Also, I think your comments about the reverse mergers and the reverse lead auditor, auditors did all the work issues on the China reverse mergers. Absolutely. And if this helps address that and improves that, wonderful. Good. That's really good. I'd ask how much of this is being driven by that.

But just so everybody understands; and David and others will correct me, because I don't know if everyone understands what other auditors are -- so we have an audit in the United States and we use 16 different offices and they're all Accounting Firm, LLP. Same one. Pick the four or six firms. There are no other auditors involved in that audit, right? It's the one U.S., LLP.

Correct, Marty?

MR. BAUMANN: Say that again.

MR. HIRTH: So we have audit U.S. operations only, but I use eight or 10 offices of my firm in the U.S. No other auditors.

MR. BAUMANN: That's correct.

MR. HIRTH: Correct.

MR. BAUMANN: That's the same firm.

MR. HIRTH: Now I have an audit and I use my office, as Bob says, in the U.K. And we have the same name. We are not the same firm. And he's another auditor, correct?

I just want to make sure everybody understands that. Okay?

Then let's go one step further: We use the same name. There are some firms that don't use the same names, but have a network and might have an international client. And I'm called Bob Hirth, LLP in the U.S. and I just Jim Doty, LLP in another country. We're part of the same network, we're calling the Marty Bauman network. He's another auditor, right? So I want to make sure you kind of understand that.

So Bob and I are using the same firm's name, but he's the other auditor. Just want to make sure everybody sort of understands all that. And I think there are some -- so I think the overarching goal here is the same, but there's all these different permutations of same firm in one country. That's one LLP. Firms that use the same name and now they're other auditors. There's looser affiliations. And then there's this revision you're going to make to -- I'm called --

CHAIRMAN DOTY: You're in real trouble if you're relying on me for audit --

(Laughter.)

MR. HIRTH: But and then there's this issue of using a totally different firm and looking at reliance. So I want to make sure everybody kind of understands that. So I support that.

And then I guess I'd be interested in what the other firms think. And then also what the non-U.S. participants here think about this as well.

MR. WILSON: So just for clarification, in your example; I just want to be sure that we've let everyone on the same page here, you're right, everyone is -- in all those examples you're talking about multiple firms. Maybe they share the same name. Only the lead auditor issues the report. It's not the network that issues the report. Only the lead auditor issues the report. So I think that's an important factor in the way that we think about it. And you're right, it helps drive some of the thinking on the proposal.

So you ask about responses from firms. So, David Kane, your name was on the list; not to put you on the spot, but you were next in line.

MR. KANE: Sure. Well, I think just I agree with what Bob said in terms of the legal structure. And I think this effort and the Board and the staff should be commended, because I think this is an important topic to improve audit quality more globally.

I think Form AP is going to help when you start putting these together, because starting next June for reports we issue -- are issued or reissued after next June, according to the five percent, investors will have that transparency and will be able to understand exactly same firm name, different firm name, level of participation and have the power and the benefit of that information there.

I mean, my overall sense is; and I think this rule proposal captures it, that I think some of the larger firms have been already incorporating a lot more review and supervision over the last several years. I think it's never been greater than it is today. You see much more having people from the primary team actually go over to the local countries and the component teams to sit down with them, particularly in some more challenging areas, let's say, like in terms of ICFR. So I think the days of just grabbing summary packages and just limiting it to what's in AU 543 strictly are in the past. I don't think that's current practice today.

And I think one question I did have was though, just on the AU 543, how much the Board meant to tighten the sufficiency of work and the determination of lead auditor. Here's the reason I ask that question on that: Is another consideration here is state law. So in many states for companies that are headquartered in that state they have to be audited by a firm that is licensed and registered to practice public accounting in that state, which in many cases requires U.S. CPAs, to majority own that firm.

So you could end up in a situation, depending upon how much the AU 543 current criteria we're going to be restricted a bit more, that the lead auditor might actually be a foreign firm that would not be licensed to practice in that state and potentially issue that report. So there might be some companies that are left a little bit in no man's land. So I just think the state/local laws around the world are going to be another consideration here when also just thinking about determining who the lead auditor is.

MR. WILSON: Thanks. That's a really good point. I think that's an area that we are interested in understanding some of the issues that people may run into in that space.

I think the main thing was I think it was felt to be important that the lead auditor not -- to have -- do a meaningful portion of the audit work themself, that in order to be able to credibly be able to sign the report. I think the question then becomes what's the criteria one uses for that, as you alluded to. And what the proposal does was apply the criteria essentially that are used in determining the scope for multi-location engagement, which is driven by risk.

So we're interested in whether that risk frame helps, whether that seems to have -- whether people are finding that that causes some kinds of issues that may come up in practice or how that plays out. But we thought that was a more meaningful and realistic approach than simply the approaches that sort of have one criteria for sufficiency and participation, the old AU 543, and a different criteria for scoping the audit. So we're trying to bring those in line and thought we'd get to the -- roughly the same place.

MR. KANE: Yes, so I think there are some opportunities we have in the comment letter to give you some fact patterns and some things to think about.

Another one just on that thought on risk of material misstatement was did you consider or is one required to consider the financial reporting determination and where that is? So, one of the things that's in there is that wherever the financial reporting decisions are made, typically you think about that. Is that a requirement? Because sometimes you could have situations where the risks of material misstatement are completely different than where the financial reporting decisions are made.

MR. WILSON: Right. So the proposal itself hinges on the risk of material misstatement, so however that might be. I think what the proposal also tries to point out is that there are situations in which there are some unique risks around the financial statements that otherwise might not be addressed. So we're thinking about whether or not there are situations where someone may operate say a very large operating subsidiary, but not have any visibility into the financial statements and questions about then how would that auditor be able to reach an opinion and sign a report?

So those are some of the thoughts, but we're very interested in comments in this area.

MR. KANE: Yes, and just one last observation here; and Bob Herz touched on this, but I think it's an important one that's more take-away for us in thinking about in terms of a firms reliance on, or a partner's reliance on system of quality control versus what they specifically need to do.

I think the principles that are outlined in here make a lot of sense. It's just more of how does the primary team document and execute and evidence some of that? So when you start thinking about ethical requirements or independence can reliance on global code of conduct or independence monitoring, if you have a global system, can that satisfy? So it's just some take-aways for us to think about as well in terms of how to strike that right balance to make sure that the evidence is there and it's meaningful without a check-the-box.

MR. WILSON: Right. No, those would be -- those are helpful comments for us, hopeful thoughts.

MR. BAUMANN: I just wanted to get into the dialogue a little bit. This is a really important point in the release; and we are seeking comment on this, sufficiency of participation by the lead auditor in the audit. Some cases are probably pretty black and white where 90 percent of the work is done in the U.S. and there's a subsidiary somewhere that represents 10 percent of the assets and revenue. And it's probably pretty obvious with all the key decisions made in the U.S. and most of the assets and revenue that the lead auditor's participation is sufficient.

Some others are probably pretty black and white when -- Bob I think talked about, Bob Hirth, the reverse mergers where 98 percent, or some very high percentage of the revenue and assets are in some other country and there was a reverse merger, and some U.S. firm was signing the report that was formerly a shell company. And now they, via the reverse merger, are a registrant with such a great portion of that work being done by some overseas firm with maybe today under 543 very limited involvement by the lead auditor. Maybe that's a black and white situation that they're just not doing enough work to really sign that report. That might be black and white.

And then you have the situation with a very diversified company that's got 10 percent of its assets in revenues in the U.S. and 10 percent in nine other countries around the world, and each of those 10 operations in different countries are all important. And then assessing the lead auditor's responsibility. There a key element is probably the degree to which they exercise the responsibilities of this standard, they were sufficiently involved in the risks of material misstatement in those other entities and they're probably auditing the lead consolidation where key financial reporting decisions and disclosures are made.

So there's an infinite, maybe, number of situations to be considered in this sufficiency decision and information you all can provide us as to what are some of the challenges of implementing this, yet coming up with the right goal of saying the lead auditor needs to have sufficient participation to actually sign the accounts is important. So information, other empirical evidence, various types of situations and evaluating those would be very helpful in the response to the questions we ask in the release.

MR. WILSON: Liz Murrall, I think you had your card up earlier and put it down. Did you have a comment?

MS. MURRALL: Well, just very much welcome the improvements that are being made for the supervision of auditors and how this will improve audit quality.

MR. BAUMANN: If you'd move the mic a little bit, Liz?

MS. MURRALL: Oh, sorry. Is it not on?

MR. BAUMANN: Oh, just a little closer. Thank you.

MS. MURRALL: Okay. Sorry. Thank you.

Investors firmly believe that lead audit partners should take responsibility for the audit and stand behind the judgments, et cetera, that are made. One of the concerns that I've had that has raised quite recently is that we're aware as investors that each of the firms and each firm in a network will have quality control procedures.

The IAASB has recently been consulting on audit quality, and in that it's looked at professional skepticism, quality control and group audits. And I suppose I was somewhat concerned that the quality control procedures were not reviewed at the network level, particularly given the international nature of audit and the international nature of the audit firms, that this is not actually addressed in the standards. And whether or not, and if that cannot be done because of the differing structures of the networks, can it not be done at least at the engagement level?

MR. WILSON: Thanks. And that is something that we're going to be thinking about in terms of how the proposal -- how the issues like what were teed up earlier about how the auditor uses that, the lead auditor uses that information in the engagement level. It's also something that we'll be thinking about in our larger quality control project and how the -- what the right kinds of quality controls ought to be in those situations where there are network arrangements.

So, Brandon Rees?

MR. REES: Thank you. I wanted to also add my voice from an investor prospective in favor of enhanced oversight of other auditors by the lead auditor.

I think there's an investor expectation gap about what is expected for the supervision. I was looking at a U.S.-based multinational consumer products company just this week that had 80 percent of its revenue outside the

United States and all its expected future growth is going to be from outside the United States. And so, what does it really mean when the lead firm is signing the -- what do I think that means as an investor when the lead firm is signing it? I do believe that the transparency of other audit participants will help align investor expectations with the reality, but I don't want investor expectation to be lowered. This is the kind of rulemaking area that I think as an investor I say, well, isn't this what firms are already doing, and shouldn't they be doing? And it's sort of like one of those sort of hair raising moments where you think, well, maybe this isn't always being done and therefore it's helpful to have a uniform standard to be applied.

MR. BAUMANN: I think this was mentioned before. There's been enhancements beyond what maybe the existing standards are. But I think practice varies, so I mean, this standard is intended to get a uniform high degree of oversight and supervision in all cases and not just in some cases. So I agree with your point, it would be hair raising if this isn't done, but it's not done in all cases.

MR. WILSON: Phil Santarelli?

MR. SANTARELLI: Yes, this is probably either a naïve or a dumb question, but this concept of sufficiency which has in the standard a quantitative and qualitative element to it, which I agree with -- but my recollection is that there's still -- in the Corporation Financial Reporting Manual they actually address when acting as a principal auditor, all term, AU 543 term principal auditor, that in their view, staff's view is that the principal auditor needs to cover more than 50 percent of the balance sheet or income statement, which is obviously very quantitative. Is there a little disconnect there? I'm sure practice has evolved, but it's still in that FRM.

MR. WILSON: I believe the requirement you're referring to is the auditor will assume responsibility for, so I think these concepts are compatible in that we would imagine that -- and as today in most cases the auditor is assuming responsibility for that work of the other auditors.

MR. SANTARELLI: Right.

MR. WILSON: Philip Johnson?

MR. JOHNSON: Thank you. One of the concerns I have here is in regard to networks and the fact that irrespective of what we've heard, that the firms have gone a long way to solving a lot of these issues over the years, changed their methodologies, changed their involvement of lead partners.

In the standard, in the proposed standard there doesn't seem to be any recognition of that with regard to network firms and the supervision of those network firms. So as Bob said, if it's a U.K. firm, whether it's PwC or KPMG, then they're treated as if it was somebody outside the network.

That concerns me, in particular when we're looking at enhancing, as Liz mentioned, the quality control procedures within firms. There is common methodologies. And I just sense that we may be burdening too much the lead auditor and not taking into consideration the fact that he or she does have influence elsewhere. The firms have influence over each other in different jurisdictions.

And so, spending all their time supervising in situations where it is almost replicated and would be a similar situation if it was -- the work was being done in Los Angeles for a New York partner. I just get a bit concerned that the standard is just going a little bit too far and ignoring the concept of networks.

I did listen in on the web cast. I asked the question, and David picked this up, about involvement of the lead partner in other jurisdictions. And I understand that firms are increasingly sending lead partners and lead managers on group audits to other jurisdictions using local personnel, but actually having the direct supervision of the work that's being done and reviewing that.

And I didn't see in this proposed standard that that was being covered. Is it or is that deemed to be another auditor, or is it deemed to be an extension? Because the definition of employee seemed to indicate that it was the employee in the U.S., of the U.S. firm and not the employee within the network.

MR. WILSON: Well, I'll start. I think in the situations that I understood that David was describing were those in which the lead auditor had senior people going to other -- going to -- let's say from; pick which one's the lead auditor, the U.K. or the U.S., and going from -- the lead going to the other and doing some review work there and being boots-on-the-ground, if you will, in that location. And in that case they would be -- that would be a supervisory action by the lead auditor under our standard.

As to your broader question, what the attempt was was to try to describe those activities that would be appropriate for a lead auditor in terms of supervising and being involved with supervising the work of other auditors, but they hinge on the three overarching principles that are in our existing supervision standard today, which are risk, the nature of the work and the qualifications, if you will, of the other people.

So they are in a sense agnostic as to whether or not there is an effective network system, but I think we'd be interested in comment on whether or not the extent to which the -- in a network arrangement, an effective network arrangement they may be achieving some of this in the natural activities. I think the release does make clear that we do acknowledge, as Marty said, that there are a number of improvements that the firms themselves have made.

To the extent they're already doing many of these things, there's probably going to be little incremental effect on what they do under this proposal, but it's conceivable that one may have a better understanding and more confidence in the knowledge and skill of the other auditor, and therefore that would have an impact on the nature of the supervisory activities.

MR. JOHNSON: But it is very prescriptive though, isn't it? I understand about the supervision aspect and being in the current standards, but the firms have done an awful lot of work to enhance their global networks, their compliance within global networks. We know every firm has good offices and poor offices, but the partners know that. And if that work is being done, we seem to be not giving any credit to the firms for all that work that they have done and said you are no different than you are if you're coming from outside the network and I don't have any influence, or the global network doesn't have any influence on the quality within that firm. That's only my point.

MR. WILSON: Okay. Well, we'll be interested in getting comment on the extent to which that's the case. I think what the standard really requires is informing people of what they're supposed to do, reviewing their work, seeing how the information came together and it was properly coordinated. And so, I think there are provisions to allow for an appropriate amount of scalability, but we'll be interested in comments that we get.

MR. BAUMANN: I just want to echo some of the things. You raised a lot of good points, Philip, as always, and I just want to acknowledge a couple of things that Keith said there. And I was going to make the points, and then he did.

So I mentioned the feedback loop from our oversight activities yesterday in talking about our standard-setting process. So to start with, over the last several years our inspections of seeing many deficiencies in the work performed at subsidiary locations around the world by other auditors.

I think in response to that as part of the remediation firms have done a lot to try to improve the oversight by the part of the lead audit firm in, as you said, visiting many of the other key locations around the world, meeting with and working with those engagement teams to ensure they understood the goals of the engagement team, the risks that they saw and what the expectations were, making sure they had the quality people on the ground, et cetera, to do that work.

I think our release acknowledges that first the firms moved to ISA 600. That made some advances, yet there was continued deficiencies. And firms have made some improvements, a lot of improvements in many cases today where they are doing a lot of the things that are in this standard. And I think as Keith said if a firm has really upped its game to that extent that they are visiting other locations, giving clear instructions and direction to the other auditors, obtaining key documents back to review and getting the reports from those other auditors, there may not be a lot of change necessary at those firms or those engagements where that's happening. And that's great.

So if there's not a lot of cost to the system because in many cases firms have remediated some of these problems through inspections, that's fine. This is to bring the oversight of other auditors to that high, consistent level in all cases.

MR. WILSON: Jay Hanson, did you have a comment on this?

MR. HANSON: Yes, I want to go back to a couple things that were said about the sufficiency determination.

And, Brian Croteau, you were out of the room when Phil raised the question. I want to go back and repeat that in just a second.

But the point that David raised about the sufficiency determination, for me personally of all the things in this proposal and acknowledging that many of the things that we've put in there are already in place by some firms, some teams -- so we're trying to level-set for some of the best practices we're seeing. But the sufficiency determination is the one that should give firms the most pause about how is this really going to work, and will this change practice? And so, I think this is a good discussion.

And Phil earlier raised a question, Brian, when you were out of the room about the corp fin guidance on the 50 percent. And I want to observe that in the release and the many, many pages we've got an example, a couple examples of illustrations of the sufficiency determination. And I have to admit that with the 45 versions of it I saw I'm not sure exactly which version hit the final, but I believe there's an example of one where lead auditors auditing the corporate headquarters consolidation and a portion of the operations, but a bigger portion of the operations are audited by another firm and that you could reach a conclusion that that is okay, that the lead auditor is the -- say, the U.S. firm that audits the corporate headquarters even though that's not more than 50 percent.

And so, Phil's question, Brian, when you were out of the room was, how does this intersect with the corp fin guidance on the 50 percent?

MR. CROTEAU: Thanks for raising for that. I'm sorry I missed the question earlier.

It's an important consideration to make. If from a corp fin perspective, as I look at that at least, that's probably an unusual place for that kind of guidance, but I think it just evolved because there was not something more specific in auditing standards and wanted to have some guidance around the kinds of questions that corp fin often was asking, or would ask from time to time, where it would appear that perhaps an auditor may have been involved that didn't have sufficient participation.

So that's how that developed and got into the guidance, but we certainly worked very closely with Marty and his team as the proposal was being developed to provide feedback on how we saw that kind of a -- how it developed, what we saw in terms of questions and answers, the feedback that we were getting through the corp fin process to suggest at least what we saw as perhaps some of the practices issues in the space. Ultimately we'd be very interested in the public input and the feedback that the PCAOB receives, but in my mind a good outcome would be eventually that would go away and the guidance would be in the final standard by the PCAOB. But certainly want to receive feedback on that in the comment process.

MR. ANDRIYENKO: Brian, and also Keith responded to that by saying -- recalling the actual wording from the guidance, from corp fin's guidance where it says that the lead auditor; I think the principal auditor in the words of the guidance, should ordinarily have audited or assumed responsibility for 50 percent or more of the company's operations.

MR. CROTEAU: Yes, and it's based on facts and circumstances. It's not applied as a bright line, but that's generally -- that will -- it will generate corp fin comments and questions from time to time when it appears. That's not been the case.

MR. ANDRIYENKO: I know there are a few other tent cards up. I think we already started talking about sort of not so much about the lay of the land, which was the first slide on, but also the differences between working with auditors in the same firm and auditors outside the firm. So maybe it's a good time to move onto our second slide and put that question up.

MR. BAUMANN: Keep your cards up because all of these questions and issues are interrelated.

MR. ANDRIYENKO: Yes. Lillian, you want to provide some background information?

MS. CEYNOWA: Sure. So working with other auditors can differ significantly from working with individuals in the same firm, which can pose challenges. For example, the lead auditor and other auditors may work in countries with different business practices, languages, cultural norms and market conditions. Also, different firms have different quality control systems. And professional training and experience of the lead auditor may differ from those of the other auditors.

So the question we want to pose to you today is what are your views on the challenges of working with other auditors, including challenges of supervising the work of other auditors participating in the audit engagement? And are there additional concerns the Board should seek to address?

MR. WILSON: Arnold Schilder?

MR. SCHILDER: Well, thanks, Keith. Maybe my comment is even more appropriate to this question than the previous one, but it basically relates to all four, of course.

I mentioned yesterday our comprehensive consultation enhancing all of the quality in this set. It's professional skepticism and quality control and group audits. And we roll that together because it's so interrelated. And I think this discussion is just illustrating that. The group audits section has over 50 questions that are very related to the questions that you have here, so we really are dealing with the same topics and issues.

But an illustration of why we linked it also to quality control is precisely the topic of networks. And we have two questions on that specifically in the quality control section. One is what could we do to address the issues identified in the context of networks of firms? For example, should we develop more detailed requirements application material to address the reliance on network level policies and procedures at the firm or engagement level?

And the next question is do you think it will be feasible for us to develop requirements and guidance for networks? Please provide a basis for your views.

So we have put it on the agenda. And in all fairness we were a bit reluctant in the beginning doing so because a network is not a very tangible concept, but of course it's a reality. And it's also something that in the end, users will see. It's usually a network, so we have auditors, et cetera. But how that works in practice and how much you can make use of quality management approaches in the network, that's a very intriguing question. And it relates very much also to the question that you have here, which is also linked to the professional skepticism part.

We all know the cultures and the languages -- challenging each other, reviewing each other. In some cultures that's seen as very sensitive. Maybe it's a suggestion of mistrust, which it is not. But nevertheless -- so we have to take into account all of that.

And another related element of course is the transparency that we have talked about. How much do you indeed understand about these complexities? Some are telling me we don't. We just see a name of a network and think that's all right. But some of the questions, including Bob's illustrated very well, it's even for experts quite a difficult battle.

So we will share of course the feedback that we are these days receiving on the many questions. It's very impressive. Comment letters of 40, 50 pages trying to answer and to inform our work.

And, Keith, you're very privileged because you are part of our quality control group anyhow, so you will see it immediately. But we also make public the comment letters and collate them together per question so that people see how it is.

And our planning is that we in December the Board will agree on the way forward of this. So not yet an exposure draft. It's too complex for that. But really understanding and digesting the issues, and I think it's a perfect example of where again PCAOB and IAASB can cooperate a lot and learn from what we are learning from our others. Thanks.

MR. BAUMANN: I agree with that. And we're looking forward to reading all of the comment letters you get on that and integrating that into our thinking on this project and the comment letters we get. So that's very beneficial.

MR. WILSON: Dave Middendorf?

MR. MIDDENDORF: Thank you. So my comments actually were originally to address question 2, but I got anxious. I put my tent card up about 10 minutes ago.

So we've talked about some of this. Typically lead auditors communicated with other auditors through instructions to the lead auditor from the other auditor. And then many times the lead auditor would actually go visit with the other auditor team in-country to discuss risk assessments, scoping, and some times review selected work papers with the goal of trying to determine the competence of that team.

We've received inspection comments from the PCAOB over the last few years relating to how did that lead auditor know the other auditor was competent to perform the work at high quality? So we've made some changes to our processes and procedures to provide relevant information to the lead auditor to give him or her the appropriate information to determine the competence of the auditor.

So you made some comments about do they have the appropriate training, US GAAP, PCAOB Auditing Standards? What's the results of that individual's inspections from our internal inspections process and other regulators around the globe? So I think maybe to Liz's comment we have historically relied on if I'm the lead auditor and I'm using you in the U.K., we get information to our people about what's the results of our U.K. practice.

And I think the comments we've received from our PCAOB inspections has been, well, that's great your U.K. firm has the right quality control procedures, but how do you know that Liz, who is your partner on a significant component of your audit, that I'm going to then sign the consolidated opinion, is qualified?

So those are some of the processes and procedures we've made changes to, which I think are very consistent with the standard. And we'll certainly review the standard in detail and have further comment, but we're supportive of in general the philosophy behind it.

MR. WILSON: Thanks very much. That's very much in line with some of the thinking that went into the proposal. So thanks.

Tom Selling?

MR. SELLING: I'm a little bit unsure of myself about this question for a couple reasons. I don't know whether it fits in this category. Looking at all four categories I'm not sure where it fits, so I thought I'd take a stab here. And also, I want you to understand that I'm primarily asking this question out of ignorance and I'm looking for information.

My gut feel is that from an investor protection perspective that one principle of this project should be that the lead auditor should be the central repository for all the work papers, but under the standard they're not. And I'd like you to educate me as -- this seems obvious to me. I'd like you to educate me a little bit as to the jurisdictional constraints you're working under to derive the solution you did.

And my concern is that; and again, I'm not that sophisticated in this area, it does appear that there are opportunities to game the system, like the way you set it up. For example, it seems that there have been and there still are incentives to work as multiple firms solely to shield working papers. And so, please answer the best you can.

MR. BAUMANN: I just want clarification on the last question, something on multiple firms. I didn't hear the --

MR. SELLING: It seems that there are incentives that -- where especially -- what I'm thinking, and this kind of goes back to Rick Murray's comment earlier, is that technology has changed tremendously, that the availability of electronic documents and stuff like that seemed to reduce the need for being in geographically diverse places. And so, there's a certain irony here in this standard that we're talking about working with multiple firms when technology and electronic documents would make this less urgent than it used to be. And it seems that the opportunity to shield working papers may be a perverse incentive to work as multiple firms instead of as one firm.

MR. WILSON: So would be interested if others think that there is an issue. I would tell you that we already have a standard, Auditing Standard Number 3, that requires that the office issuing the report has access to all the work papers. So they may not have to have them physically present, but they have to have access to all the work papers. Then for certain other, certain specific key work papers, they're supposed to obtain -- review and retain them. That's under our existing standards today. The idea --

MR. SELLING: I'm sorry to interrupt. My question is solely about document retention.

MR. WILSON: Yes, and that's what I'm talking about. So they are supposed to be -- today the lead audit firm is supposed to have access to those work papers.

We're interested if people think that somehow there is something about the proposal that changes that, but in our view those requirements, in what we refer to as Auditing Standard Number 3, remain intact. And so, those obligations still exist under existing standards. So we haven't changed that part.

What we've changed is what the lead auditor would do in terms of supervising that work, which obviously includes some review elements, but it hasn't changed the fact that they still have to have access to all the work papers.

MR. BAUMANN: I would just echo that again. I mean, AS-3 requires that the lead auditor have access. But also with respect to retention, they have to obtain, retain and review key documents that are listed specifically in that documentation standard, and that doesn't change. So no matter where the work is being performed around the world, those documents have to be sent to the lead auditor as specified in that documentation standard.

Then with respect to your comment about electronic work papers, that's fine. I mean, to the extent that makes the ability of the lead auditor to review some of the work around the world more easy because they can get access electronically to that data, that's fine. That's certainly permitted in the standard. If that enables them to carry out the supervision more effectively in their home office by looking at electronic papers that are sent to them, that's great, or have access to.

Still there's a person issue, obviously. People doing the work is the maybe the most important thing of all. And that's why we have that important aspect of this to gain an understanding of the qualifications of the key people on the audits around the world who are performing the work. And there's a variety of ways in which the lead auditor can do that. Looking at documents, as Dave mentioned, about internal inspection reports that might give them knowledge of those people. Their professional training and competence.

But often as the firms are doing, visiting those key locations where the key risks of material misstatement exist to meet face to face, talk with those teams is a very important practice. And I think that's happening in many cases, and we encourage that.

So all of these things come into play and we're interested in the responses to that. So hopefully we've answered your question, which it's not an ignorant question. It's a good question.

MR. SELLING: Not quite. If you don't mind, let me give you a hypothetical. A restatement was necessary and there's private litigation. And my question is essentially how complicated is discovery? Can I rely on seeking discovery from the lead auditor in the United States or does discovery have to extend to part of the network that's outside of the United States in order to get access to all of the working papers for that engagement under this standard?

MR. BAUMANN: Well, I commented on this during my presentation yesterday that the -- it's a scope limitation if the lead auditor is unable to get the work that -- to see the work that they need. If they believe that they need to see specific work, review specific work papers, get a specific report, if they can't get it, that's a scope limitation. So there isn't any shielding that takes place that we can't provide this to you because of X, Y or Z.

If they can't send it, then the lead auditor -- it's incumbent upon the lead auditor to travel to that country to review those work papers, if necessary. If they're in a different language, to bring a translator with them to make sure they can understand them. But there's no shielding that takes place. The lead auditor has to be able to get access to the people, the work to the extent they deem necessary. And if they can't, then there's a scope limitation.

MR. SELLING: Marty, I could be totally off base. I'm talking about a point in time post the engagement, after the engagement takes place. I could be completely off base here, but I'm not talking about the lead auditor's access to the working papers during the engagement. I'm talking about a year later after a misstatement is discovered. And in order to protect investors they need to be able -- and under private securities litigation they need to be discover the working papers. That's what I'm talking about.

MR. WILSON: Okay. I'm not going to offer any legal opinions about what is discoverable or not in front of that. I will just say that this proposal -- I told you what the standard says. And the proposal doesn't really change the existing obligation for the lead auditor to have access to all of the work papers, including the work papers of other firms.

So, Karen Nelson?

MS. NELSON: Yes, thank you. In reading this proposal I was struck by how much discussion there was regarding the incentives of the lead auditor and that this proposal was going to increase incentives for supervising the engagement.

What struck me though was that there was pretty much little to no discussion of the incentives of the other auditor. Where that came through was primarily in the unintended consequences section where there was an acknowledgement that with more responsibility to the lead auditor, the other auditor may feel the possibility that they could shirk, but yet the conclusion was that the heightened supervision of the lead auditor would offset that.

But when I think of this question here -- well, we've moved to question 3 here, but question 2 on challenges in working in this environment is the inherent challenge working with an other auditor and the staff of the other auditor which may not have the same incentive alignment with respect to this engagement.

And I guess the parallel that I draw, which may or may not be exactly on point, is the idea of a substitute teacher. As a substitute teacher, you have the documented technical capabilities, skill set, whatever to take the class, but your incentives may not be the same as if this was my class to do the same job. I'm in there as a substitute.

And so, I think of that in this situation, the incentives of the other auditor. And I've talked to audit staff where in some cases you want to be on the engagements that are the plum local engagements for that audit location where you're going to attract the attention of the partners and other higher levels in that office. That's the engagement to be on. Being on another engagement is something where you may not get the same evaluation and recognition for your skills and capabilities.

And so, in looking at this with respect to working with the other auditors, I would encourage more thought perhaps on how the incentive structure for the other auditors is playing into some of these issues along with just the other -- and challenges that were on the previous slide.

MR. WILSON: Okay. Thank you very much. Those are thoughtful comments.

I do think one of the points that we make in the proposal is an observation, at least there are some indications, that greater lead auditor involvement does seem to affect audit quality by the firm, by the other auditor firm. And so, it will be interesting -- maybe further information, about whether or not that, the phenomenon results from maybe changing incentives through more close supervision or some other factors, but would we be interested in that.

And your comments are well taken. Thank you.

MR. BAUMANN: Yes, I agree with that. And we do, I think as you mentioned, Karen, note in our economic analysis the principle agent relationship between the lead auditor and other auditors, and the different incentives they can have. There can be very different incentives on the part of the lead auditor, as you said, for that plum engagement versus other auditors who may be more interested in the key engagements in their market, and the risk of shirking is discussed.

And that really drives many of these requirements for the lead auditor to be more engaged in the work of those other auditors and have the greater oversight to improve the work of those other auditors and have higher quality. So I think we're trying to get at those issues and certainly interested in more comments about that. Thanks.

MS. NELSON: Well, if I may just follow up on one comment there. I believe and I've spoken with some of my colleagues that there is some research, particularly in the managerial accounting area, that talks about increasing the monitoring of the principle may have an offsetting decrease to the agent. And so, it's not necessarily clear that there were would be a net benefit or a net gain by this. And that was all the point that I was trying to draw.

MR. ANDRIYENKO: Maybe this is a good segue into our third question. We're talking about the increased involvement of the lead auditor into the work and evaluation of the work of the other auditor. There are some emerging indications that this increased involvement by some of the firms produced certain results, positive results.

And the question is about your views on whether the quality of the other auditors' work in significant audit areas can be improved through increasing the lead auditor's involvement in that work. So maybe some of the firms can talk about their experiences. I know that David and -- both Davids touched on that earlier, but if there's any additional information that would be --

MR. BAUMANN: Three Davids.

MR. ANDRIYENKO: Three Davids. Thank you.

MR. BAUMANN: It sounds like the name of a restaurant, Three Davids.

(Laughter.)

MR. ANDRIYENKO: Close to lunch.

MR. SULLIVAN: I just thought, since I hadn't weighed in I would also weigh in with the other Daves on this. Certainly as we have changed our internal --

MS. WATTS: Can you move your microphone closer. Thank you.

MR. SULLIVAN: Thank you. Certainly as we've changed our internal policies on the supervision of component auditors, we have seen a significant improvement in the quality of the work that's performed in those locations, whether we measure that through our internal inspections or the external inspection results of those component engagement teams.

But we continue to work through some of the unintended consequences as well and wanting to make sure that we're considering not just the short-term audit quality improvement, but making sure that there's a long-term sustainable model to build those skills in around the world so that these audits can be performed at a consistent level across the globe.

MR. WILSON: Phil Santarelli?

MR. SANTARELLI: Yes, the focus has been, and appropriately so, on the lead auditor's responsibility. And I'm just wondering, and this might be again in the nature of a naive question, but if the component auditor is auditing a significant portion of the issuer, they must be registered with the PCAOB. Is that correct?

(No response.)

MR. SANTARELLI: So does the PCAOB have any ability from an oversight perspective to actually do some standard-setting on the other auditor's responsibility? In other words, create some incentives in your rulemaking where the other auditors have to cooperate or have to at least interact in an appropriate way with the lead auditor versus the lead auditor kind of pulling? Is there any push that can be done there?

This is a question that when the ASB was writing AUC 600, drafting on ISA 600 -- it just occurred to me that we were changing the dynamics so much and what the other auditors really were expected to do. And I remember saying often, should we do some standard-setting if you're acting as an other auditor to enhance that cooperation and so forth? And for whatever reason, we've never been able to do that.

I don't know if it's just jurisdictional or the ability to actually impose that, but certainly in the ASB world that would be so because there is no -- but if they're registered with the PCAOB, is there a way to kind of put rules in or an expectation in for cooperation, as it were?

Okay. Now I understand that the global networks -- I'm sure that's almost a given, but as you've noted not all of these are global network-type situations. So, just a thought.

MR. WILSON: Thanks. And the firms that do play a substantial role as defined in our rules are required to be registered with the PCAOB and are subject to inspection.

Your point about should we have some kind of additional standards or guidance or something, we'll have to give some thought to. And appreciate the comment.

Bob Herz, you've had --

MR. BAUMANN: Just, I'll add to that. Of course if the other auditor is auditing an estimate or fair value measurement in that foreign location, they're subject to PCAOB standards on auditing fair value measurements with respect to that. But your general comment of should there be more general guidance about other auditors is something for us to think about, and interested in comments on that.

MR. WILSON: So, Bob Herz?

MR. HERZ: Yes, my comments are along the line of what Dave Sullivan was pointing at, but from an audit committee point of view. The audit committee is really important, that the lead auditor is a significant component of a worldwide audit, be the right person, be competent, in fact, and that the team be people who are qualified and that.

And I think best practice is to actually make the audit firm go through succession planning and the kind of things that Dave was talking about, bringing up people from different parts of the international team to do rotations and come to the head office as part of that audit and go back to the national country. It's not something necessarily you'd build into your standard, but it's all those kind of considerations that really go into really assuring that the worldwide audit is being done on a good basis.

MR. WILSON: Thanks. Good points.

David Kane?

MR. KANE: Yes, thank you. I mean, certainly each firm is going to be required to maintain quality control standards, right, and comply with those. But when I think about the journey we've been on in terms of the U.S. in audit quality and all of the training and the messaging and the emphasis on that, you've got very bright people around the world who want to get it right but sometimes need a little bit more help from primary teams to understand exactly what the requirements are and the specific application. Because there's one thing to think just about the theory. There's another one about just bringing it to life with that.

So I think in that spirit there's been a lot from U.S. that's been exported around the world, particularly when I start thinking about the training. And I think it's helpful, at least from a global network standpoint, because the messaging on the tone at the top and the quality, at least you understand exactly what that looks like because you're living it and you know the messaging that's being delivered around the world as well.

And you're also dealing with some structural headwinds that need to be considered. In some places the level of education and training, whether it be on terms of accounting standards or auditing standards isn't the same place as it is here. You've also got language and culture barriers that need to be thought about as well here.

So I mean, coming back to the question, I think to me there's no doubt getting the lead auditor more involved in terms of component teams and thinking about multi-location audits has a direct impact on improving audit quality.

MR. ANDRIYENKO: Our final question for today is on the subject that came up yesterday early in the day and

I would like to continue our dialogue with respect to audits in which the lead auditor divides responsibility for the audit with other accounting firms. And Lillian would like to make a few remarks.

MS. CEYNOWA: Sure.

MR. BAUMANN: Yes, there was a lively dialogue on this point yesterday.

MS. CEYNOWA: So I'll just throw it out there. In some audits, the lead audit divides responsibility for the audit with another accounting firm. For example, the lead auditor may divide responsibility for the audit with another auditor if it is impracticable for the lead auditor to review the other auditors' work. A more specific example of divided responsibility between auditors might occur, could be in the year when an issuer acquires a company audited by another auditor.

The proposal would continue to allow divided responsibility in certain circumstances. What are your views on whether it would be appropriate to retain the divided responsibility model in PCAOB auditing standards as proposed to be revised?

MEMBER HANSON: Lillian, before we open up can I ask you a question? So the release talks about the frequency at which this happens. And so, of the roughly; I can't remember the number, 15,000 to 20,000 annual filings that the SEC gets every year how many of them currently do this, about?

MS. CEYNOWA: Very good question, Jay.

(Laughter.)

MS. CEYNOWA: Audits in which the lead auditor divides responsibility with one or more other accounting firms is relatively uncommon. Based on our analysis of SEC filings as of May of 2015 there were approximately 50 audits in 2014 in which the lead auditor divided responsibility with another auditor.

MEMBER HANSON: So this discussion is about the 50 out of the 15-plus thousand?

MR. BAUMANN: I think that puts it into context. An important question but a rare situation. And, but, Lillian gave a good example of an acquisition being made during the year, another auditor is involved and the lead auditor didn't plan part of that audit and may not have enough sufficient time to do that. And that might be a case where -- divide responsibility and that other auditor take responsibility for their work and the lead auditor for the remainder of the audit. Those are the kinds of situations where that occurs.

MS. CEYNOWA: Now, I was just going to add in our release where we talk about unintended consequences, we do cite this as potential of going up because of -- some may view the cost of the proposal is too high and might increase the divided responsibility options. So we do talk about that in the release.

MR. WILSON: Dave Sullivan?

MR. SULLIVAN: Well, you just said what I was going to say, which is that -- so I don't have an answer to the question, but really that question, which is to what extent will this increase because of the additional responsibilities imposed on the principal auditor, which may be an unanswerable question, but it's an important one to consider because I think it also -- it is an uncommon situation today.

And in my personal opinion -- like if I could give a disclaimer the way you do, I'd give it right now. My personal opinion, I think it's probably good that it's uncommon. I wouldn't want something like this to be the reason it became more common.

MR. WILSON: Philip Johnson?

MR. JOHNSON: Well, I stated yesterday what I think about this subject. I don't like divided responsibility. I know it's a U.S. phenomenon. There are only 50. And I'm more concerned about the separate -- if it's felt to be acceptable and controllable, then that's how it is, but to put it in a -- have a separate standard for divided responsibility, which I think is the proposal, it just heightens awareness of this and I just wouldn't like to see the standard causing more incidents of divided responsibility.

But having said that, I -- it is only in the U.S. and it's not something that I subscribe to because I just believe that the lead auditor should take responsibility for the financial statements as a whole.

MR. BAUMANN: I think we agree, or I agree with the disclaimer that I'm glad it's rare instances, as Dave Sullivan said, and we raised that question specifically that Lillian pointed out because we don't want the unintended consequence that this greater oversight would lead to a greater separation of -- or divided responsibility. And we'll take that into account if people thought that were the case in our final recommendation to the Board.

I just thought I'd ask, though, Mike, the ASB, when you went through your clarification project post the IAASB, which doesn't have the divided responsibility, I do believe the ASB, while adopting essentially the principles of ISA 600 nevertheless did continue to permit divided responsibility. Am I right there? And if so, I was wondering what your thinking might have been.

MR. SANTAY: Yes, we did. And I think as we go through the process of clarification and convergence, which is still one of our main objectives, convergence with IAASB, we also look at differences, jurisdictional differences that we think are important.

Obviously, the SEC allowed divided responsibility. There are certain situations -- I think you highlighted them in the discussion yesterday, where there's operational challenges where the Board felt that it was important to differ from the IAASB. I don't think we have many differences in the Group Audit Standard. Obviously, that's a fairly significant one, but it's one that in our assessment of the ITC that's come out that Arnold's -- the IAASB has issued, our comment letter is still supporting a divided responsibility regime.

MR. BAUMANN: Thank you.

MR. WILSON: Yes, and I'd just say so far there seems to be a strong sense of, well, if we're going to have these, let's keep them rare so any comments anyone might have, either today or in -- hopefully we'd appreciate any written comments on ways to continue to do that. That is one of the questions we're asking. Should we keep it and should we place -- what kind of limitations or additional limitations should we put that.

Liz Murrall?

MS. MURRALL: Yes, thank you. Well, as I've said, I mean, investors really believe that the lead auditor should take responsibility for the audit and the judgments in that audit. And as regards divided audit responsibility, as we've heard, it's not required internationally. It's not allowed internationally. And I just fear that it could be perceived that sort of lesser standards were being applied here. I don't think that's necessarily the case, but it could be perceived.

Investors do invest internationally and consistent reporting requirements under this would be welcome.

MR. WILSON: Okay. Thanks. Bob Herz, you get the last word on this.

MR. HERZ: Yes, I just kind of wondered whether the instances of divided responsibility might increase over time given the E.U.'s requirements on mandatory auditor rotation. So if I posit a situation where a U.S. company that has significant European operations would wish to retain its overall U.S. auditor, but says I'm fine saying PwC in the U.S. and E&Y in Europe and the audit report reflecting that.

So I don't know whether it's good or bad, or whatever. I'm just thinking that could increase the number of those situations.

MR. BAUMANN: I think it's an important factor and interested in comments that people might have on that as that takes place over in Europe and as the mandatory rotation kicks in.

Sir David Tweedie, did you want to respond?

MR. TWEEDIE: Not to that, Marty. I was just going to ask Arnold, did this issue come up in the IAASB, and what was the reaction when I suppose some of the American members put this forward?

MR. SCHILDER: We have asked a question about it as a result of the discussions that we had also looking to the U.S. situation. So we are currently awaiting the comments. What I've seen so far is there's not much appetite for reference in this way to other auditors, but we still have to look at the comments in total. My guess is it will be unlikely that we will change the principle. But nevertheless, for example, some comments are pointing to the situation which I think is in your documents, as well. Equity investments, difficult to audit. So should that be a reason that the overall principle as a result -- which had -- delete all the -- taking full responsibility for a full audit is a very key principle. But nevertheless, we've asked the question.

MR. TWEEDIE: And with Lillian's question about the acquisition very late in the year and another auditor has been doing all the planning and working, how does the IAASB deal with that?

MR. SCHILDER: We haven't discussed this specific example. Still, starting from the point you have to do what you can to understand and review that audit yourself to the extent that you basically can take over. So likely; I say Marty pointed to that yesterday, it might be that that's not possible, or have a scope limitation or so disclaim from an opening balance sheet or so. That will be more in line with that principle. But nevertheless it's an interesting example.

MR. ANDRIYENKO: I think on that note, I'm just going to thank you for the discussion today. Thank you for comments and views. They will certainly guide us in our next steps as we move towards finalizing the proposed rule. We also encourage investors and investor advocates, auditors, preparers, other constituents to send us comment letters on the proposal.

On the screen in front of you, there is a slide reminding you of how and where to submit your comment letters. The comment period will be open for another two months and a bit until July 29th.

And with that, I'm going to turn this back over to Marty. Thank you.

MR. BAUMANN: Thanks, Dima and Lillian and Keith, for -- and all the SAG members for a very thorough and good discussion on this very important proposal on supervision of other auditors.

I'm going to keep with tradition on the SAG Chairman's wrap-up and do that in about 30 seconds, as people are anxious and eager to catch lunch, planes, travel, et cetera.

So we got a lot of great information from you on the various different standards that we've proposed, the emerging issues that we need to address. And it's been just another excellent discussion, and we appreciate very much your involvement.

So thanks. Safe travels. And you'll be hearing from us again very soon.

Chairman Doty, I think, wants to make a remark.

CHAIRMAN DOTY: I just wanted an additional 15 or 20 seconds to thank the SAG members for what I think has been an extraordinarily productive and stimulating SAG meeting. The presentations, the breakout sessions, the general good humor and good will, and also the really quite helpful and insightful information we got is going to be very useful to us. Thank you, all, for doing this. Thanks to the chief auditor and his staff for putting this together. Well done. Thank you.

MR. BAUMANN: Okay. Good day, everybody.

(Whereupon, the above-entitled matter went off the record at 12:29 p.m.)